



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

OFFICE OF  
CHIEF COUNSEL

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CC:ITA



Dear [REDACTED]:

This letter is in response to your inquiry dated April 10, 2002, on behalf of your constituent, Mr. [REDACTED]. Mr. [REDACTED] wants a review of [REDACTED] v. *Commissioner*, T.C.M. [REDACTED], a tax case which upheld the Internal Revenue Service determination that

Mr. and Mrs. [REDACTED] were liable for additional tax for [REDACTED]. Apparently, Mr. [REDACTED] takes offense to certain requests for findings of fact in the brief filed with the United States Tax Court by the IRS counsel.

The [REDACTED] have exercised their rights as taxpayers by contesting a tax deficiency, which the court upheld. The collection process is under way, and the safeguards authorized by law have been extended to the [REDACTED]. They may not relitigate or raise issues the court has already decided. Below is a detailed explanation of the events surrounding their case.

**Underlying facts.** After his employer proposed to terminate him for disciplinary reasons, Mr. [REDACTED] filed formal complaints with a state agency and the Equal Employment Opportunity Commission. He alleged discrimination based on age and disability and sought damages for financial loss and pain and suffering. Prior to the hearing before an arbitrator, the parties agreed to settle. Mr. [REDACTED] agreed to withdraw his complaints and to retire. As consideration, his employer made certain payments to Mr. [REDACTED], including \$ [REDACTED], comprising one and one-half times his annual salary. Subsequently, a dispute arose between Mr. [REDACTED] and his employer over whether this amount was taxable. The arbitrator issued an opinion agreeing with the employer that the settlement agreement did not support Mr. [REDACTED] position that the parties intended the settlement proceeds to be tax free.

Mr. [REDACTED] also failed to repay \$ [REDACTED], the outstanding balance of a loan received from the state retirement system. The system satisfied the loan by deducting the amount

due from Mr. [REDACTED] retirement account. The [REDACTED] did not include either the settlement proceeds or the outstanding balance of the loan in their gross income for 1994.

After the IRS determined that both amounts were taxable, the [REDACTED] filed a petition with the Tax Court.

**The trial.** The [REDACTED] attempted to exclude the settlement proceeds from gross income as damages received on account of personal injuries, under § 104(a)(2) of the Internal Revenue Code. In support of the IRS' determination that the employer intended the settlement payment to be wages, IRS counsel referred to the letter sent to Mr. [REDACTED] advising him of the basis for the first notice of discipline against him and to the circumstances leading to that notice. These requests were adequately supported by references to documentary and testimonial evidence. Mr. [REDACTED] never challenged the authenticity of the documents admitted into evidence. Further, Mr. [REDACTED] was in the courtroom when the witnesses testified about complaints filed with his employer. At that time, he had the opportunity to discredit the testimony of those witnesses, but he did not do so. After reviewing the pleadings, trial transcript, and brief filed by the IRS in the [REDACTED] case, we believe any objective observer would find our counsel's conduct beyond reproach.

**The opinion.** After trial, the court rendered its opinion by applying well-established legal principles to the facts and circumstances surrounding the receipt of the settlement proceeds and the failure to repay the loan. The court sustained the IRS's determination on both issues. When the taxability of settlement proceeds is at issue, the resolution focuses largely on the intent of the payor in paying rather than on the recipient's belief as to the purpose of the payment. The court found the evidence of record did not support a conclusion that the payor intended any portion of the payment to compensate Mr. [REDACTED] for personal injuries or sickness based on tort or tort-type rights. In support of its determination, the court cited the following language from the arbitrator's opinion:

The consent Award was the complete agreement of the parties. The claim that the payments were to be "tax free" is without merit. It flies in the face of the clear language of the stipulated settlement that led to the issuance of the Consent Award.

**Post-trial proceedings.** On [REDACTED], the court entered its decision. The [REDACTED] neither filed a timely appeal from the decision nor a bond to stay assessment of the deficiency, as permitted by §§ 7483 and 7485. The court decision has become final under § 7481. After the [REDACTED] did not pay the assessed tax and statutory interest, the IRS initiated collection proceedings. The IRS advised the [REDACTED] of its intent to levy and of their right to request a collection due process hearing with IRS Appeals. The [REDACTED] exercised that right.

**Explanation of rights.** Under §§ 6330 and 6331, a taxpayer is entitled to notice before levy and notice of the right to a fair hearing before an impartial officer of the IRS Office of Appeals. If the taxpayer requests a hearing, he or she may raise in that hearing any relevant issue relating to the unpaid tax or the proposed levy, including challenges to the appropriateness of the collection action and offers of collection alternatives, which may include:

- posting a bond
- substituting other assets
- initiating an installment agreement
- proposing an offer-in-compromise.

The Appeals Officer will consider these issues and the need to have an efficient collection of taxes that is no more intrusive for the taxpayer than necessary. If the IRS Appeals rules in favor of the IRS, the taxpayer can request a judicial review in the United States Tax Court.

However, a taxpayer who has had an opportunity to dispute a tax liability determined by the IRS may not raise any issue relating to the existence or amount of that liability. Because the [REDACTED] have already exercised their judicial rights, they may neither raise before Appeals nor relitigate their tax liability that was decided in the earlier opinion. See *Behling v. Commissioner*, 118 T.C. No. 36 (June 17, 2002); *Sego v. Commissioner*, 114 T.C. 604, 609 (2000).

I hope this information is helpful. Please call Mr. Keith A. Aqui, Identification Number 50-00171, at (202) 622-4920, if you have any questions. I have enclosed a copy of the opinion in [REDACTED] *v. Commissioner*.

Sincerely,

Robert A. Berkovsky  
Branch Chief  
Office of Associate Chief Counsel  
(Income Tax & Accounting)

Enclosure